Nos. 15-233 and 15-255

IN THE

Supreme Court of the United States

MELBA ACOSTA-FEBO, AS GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO AGENT, AND JOHN DOE, IN HIS OFFICIAL CAPACITY AS EMPLOYEE OR AGENT OF THE GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO,

Petitioners,

v.

FRANKLIN CALIFORNIA TAX-FREE TRUST, BLUEMOUNTAIN CAPITAL MANAGEMENT, LLC, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Whether chapter 9 of the federal Bankruptcy Code, which does not apply to Puerto Rico, nonetheless preempts a Puerto Rico statute creating a mechanism for the Commonwealth's public utilities to restructure their debts.

PARTIES TO THE PROCEEDINGS BELOW

In addition to Petitioners Melba Acosta-Febo and John Doe, Petitioners the Commonwealth of Puerto Rico, Alejandro García Padilla, as Governor of the Commonwealth of Puerto Rico, and César Miranda Rodríguez, as Secretary of Justice of the Commonwealth of Puerto Rico, were appellants in the First Circuit.

Respondents Franklin California Tax-Free Trust, BlueMountain Capital Management, LLC, Franklin New York Tax-Free Trust, Franklin Tax-Free Trust, Franklin Municipal Securities Trust, Franklin California Tax-Free Income Fund, Franklin New York Tax-Free Income Fund, Franklin Federal Tax-Free Income Fund, Oppenheimer Rochester Fund, Oppenheimer Municipal Fund, Oppenheimer Multi-State Municipal Trust, Oppenheimer Rochester Ohio Municipal Fund, Oppenheimer Rochester Arizona Municipal Fund, Oppenheimer Rochester Virginia Municipal Fund, Oppenheimer Rochester Maryland Municipal Fund, Oppenheimer Rochester Limited Term California Municipal Fund, Oppenheimer Rochester California Municipal Fund, Rochester Portfolio Series, Oppenheimer Rochester Amt-Free Municipal Fund, Oppenheimer Rochester Amt-Free New York Municipal Fund, Oppenheimer Rochester Michigan Municipal Fund, Oppenheimer Rochester Massachusetts Municipal Fund, Oppenheimer Rochester North Carolina Municipal Fund, and Oppenheimer Rochester Minnesota Municipal Fund were appellees in the First Circuit.

The Puerto Rico Electric Power Authority was a defendant in the district court but was not a party to the appeal in the First Circuit.

RULE 29.6 STATEMENT

The corporate disclosure statement contained in the Petition for a Writ of Certiorari filed by Petitioners Melba Acosta-Febo, as Government Development Bank for Puerto Rico agent, and John Doe, in his official capacity as employee or agent of the Government Development Bank for Puerto Rico, remains accurate.

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BRIEF FOR PETITIONERS

Petitioners Melba Acosta-Febo and John Doe respectfully submit that the judgment of the First Circuit should be reversed.

INTRODUCTION

The Commonwealth of Puerto Rico is on the brink of insolvency. Its public utilities and corporations are billions of dollars in debt, and its economy is suffering from a decade-long recession. Facing the most severe economic crisis in its history, the Commonwealth enacted legislation to enable its "municipalities" to reorganize their debts in an orderly and efficient manner, while minimizing risk and dislocation to the public.

The First Circuit struck down that law, however, holding that it was preempted by the federal Bankruptcy Code, even though the Code itself offers Puerto Rico's municipalities no avenue for federal relief. The court thus left Puerto Rico's municipal utilities in a proverbial "no-man's land": barred from restructuring their debts under federal law, while unable to reorganize under local law. To reach that result, the court must have believed that Congress intended to deny Puerto Rico access to an orderly process of any kind to ease its municipalities' fiscal distress.

That interpretation of congressional intent is inherently implausible. To begin with, it violates time-honored canons of construction that embody values of federalism. It is well-established that Congress does not preempt the states' (or the Commonwealth's) historic police

powers without a clear and unambiguous statement of that intent. But there is no such clear statement anywhere in the federal Bankruptcy Code. The First Circuit pointed to 11 U.S.C. § 903(1), which prohibits state bankruptcy laws that would bind the creditors of certain municipalities. But § 903(1) is part of chapter 9, which contains the federal scheme for municipalities to declare bankruptcy. Since Puerto Rico indisputably is not covered by chapter 9, *a fortiori* it is not covered by § 903(1). And the very language of § 903(1), which applies only to "such" municipalities, indicates that its coverage is limited. That provision does not approach the type of clear statement that signals an intention to override Puerto Rico's police powers.

The court's ruling also flies in the face of the history of the Nation's bankruptcy laws. Since the earliest days of the Republic, states have been permitted to pass bankruptcy statutes for entities not covered by federal law, so long as they do not unconstitutionally impair contractual obligations. That is why this Court approved debt restructuring under state law during periods when there was no federal bankruptcy statute in effect, and why it has likewise sustained state bankruptcy statutes governing banks and insurance companies, which have long been excluded from federal law. It is presumed that Congress did not change that long-standing practice without a clear indication. *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998). Again, none is present here.

Finally, the decision represents the first time in the history of the United States that an entity has been categorically barred from seeking bankruptcy protection under both federal and state law. Prior to the First Circuit's decision, every person, corporation, organization,

and municipality in the country had been permitted to commence debt-relief proceedings under either federal or state law, provided that they met the criteria prescribed in an existing federal or state bankruptcy statute. The court below upended nearly two centuries of bankruptcy practice when it prohibited Puerto Rico's municipalities from availing themselves of both federal law and Commonwealth law.

Congress generally preempts state or Commonwealth law by implementing an extensive federal regulatory framework that displaces local regulation. Here, by contrast, Congress has not created any framework for Puerto Rico's municipalities to reorganize their debts. Rather, it has left a void. There is no reason to believe that Congress intended this lack of regulation to preempt Puerto Rico's ability to exercise its police powers to address the debt crisis plaguing its municipalities.

Accordingly, the decision of the First Circuit should be reversed.

OPINIONS BELOW

The First Circuit's opinion is published at 805 F.3d 322 and is reprinted in the appendix to the Petition ("Pet. App.") at 1a-73a. The judgment of the First Circuit was not reported but is reprinted at Pet. App. 74a-75a.

The opinion of the district court is published at 85 F. Supp. 3d 577 and is reprinted at Pet. App. 76a-150a.

STATEMENT OF JURISDICTION

The First Circuit entered its judgment on July 6, 2015. Pet. App. 74a. Petitioners timely filed a petition for a writ of certiorari on August 26, 2015. This Court granted the petition on December 4, 2015. The Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS

The official English translation of the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act") is reprinted at Pet. App. 152a-297a.

In addition, the following federal provisions of the Bankruptcy Code are pertinent to the issues on appeal:

11 U.S.C. § 101. Definitions.

* * *

(52) The term "State" includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title.

* * *

11 U.S.C. § 109. Who may be a debtor.

* * *

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity—

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

11 U.S.C. § 903. Reservation of State power to control municipalities.

This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but—

> (1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and
>
> (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

STATEMENT OF THE CASE

1. Petitioners are agents of the Government Development Bank for Puerto Rico ("GDB"), a public corporation and governmental instrumentality created by law to aid the Commonwealth in the performance of its fiscal duties and the development of its economy. *See* P.R. Laws Ann. tit. 7, §§ 551 *et seq.* GDB acts as financial advisor to, and fiscal agent for, the Commonwealth and its public corporations and municipalities. It also provides them with financing for economic development. GDB's core mission is to safeguard the fiscal stability of Puerto Rico and promote its economic competitiveness. For that reason, GDB has a strong interest in resolving the current debt crisis, which threatens to undermine the financial security of the Commonwealth and its ability to provide vital public services.

2. The Commonwealth of Puerto Rico is in the midst of a severe and deepening financial crisis that threatens the economic and physical well-being of the 3.5 million American citizens who reside there. The Commonwealth's debts currently stand at about $73 billion, with an additional $40 billion in unfunded pension liabilities. More than $20 billion of that debt is held by three municipal corporations—the Puerto Rico Highways and Transportation Authority ("PRHTA"), the Puerto Rico Aqueduct and Sewer Authority ("PRASA"), and the Puerto Rico Electric Power Authority ("PREPA"). Last summer, a Commonwealth instrumentality failed to make a $58 million bond payment that had become due; that marked the first time in the 117 years that Puerto Rico has been a United States jurisdiction that it defaulted on a debt payment. Mary Williams Walsh, *Puerto Rico Fails to Pay $58 Million Bond Debt*, N.Y. Times, Aug. 4, 2015, at B1. Earlier this month, another Puerto Rico instrumentality defaulted, and more defaults are expected in 2016. Mary Williams Walsh, *Struggling Puerto Rico Defaults on Its Debt Payments*, N.Y. Times, Jan. 5, 2016, at B6.

Over the past several years, the government of Puerto Rico has taken a series of steps to rein in the Commonwealth's public debt. Among other things, it has raised taxes; imposed severe cost-cutting measures; drastically reduced the number of government positions; and increased rates for water and other public services. *See* Recovery Act, Statement of Motives, Pet. App. 153a-164a; 2015 P.R. Laws Act Nos. 1-2, 72. But those measures have not solved the problem. With an unemployment rate hovering around 12%,[1] a shrinking tax base resulting from

1. *Hearing on Financial and Economic Challenges to Puerto Rico Before the S. Fin. Comm.*, 114th Cong. (Sep. 29, 2015)

residents leaving the Commonwealth in droves,[2] and an inability to access the capital markets, Puerto Rico cannot simply tax and cost-cut its way out from under its crippling debt.[3] Moreover, in the absence of a statutory framework governing debt restructuring, it will be exceedingly difficult for the Commonwealth's public corporations to negotiate a solution to their debt problems. Despite trying to negotiate with its creditors for months, PREPA has secured only a tentative and contingent agreement to restructure a portion of its debt. And PREPA is only one of several municipal corporations in the Commonwealth facing the looming possibility of default.

If Puerto Rico cannot restructure its municipal debt, essential services in the Commonwealth will be in peril.[4] For instance, if PREPA were to default on its

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(statement of Melba Acosta-Febo), *available at* http://www.finance.senate.gov/imo/media/doc/Melba%20Acosta-Febo%20U.S.%20Senate%20Testimony%209-29-2015%20(Final%20with%20exhibits).pdf.

2. Jaison R. Abel & Richard Deitz, *The Causes and Consequences of Puerto Rico's Declining Population*, 20 Fed. Reserve Bank of N.Y. Current Issues in Econ. & Fin., no. 4 (2014), *available at* https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci20-4.pdf.

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4. *Hearing on Exploring Energy Challenges and Opportunities Facing Puerto Rico Before Subcomm. on Energy & Mineral Res. of the House Comm. on Natural Res.* (Jan. 12, 2016) (statement of Lisa J. Donahue, Chief Restructuring Officer, P.R. Elec. Power Auth.), *available at* http://naturalresources.house.gov/ uploadedfiles/testimony_donahue.pdf.

debts, it would likely find itself unable to secure the credit necessary to make its monthly fuel purchases—which would imperil its ability to generate sufficient electricity for the Commonwealth's residents and would likely result in rolling blackouts.[5] By the same token, a default by any of Puerto Rico's public corporations that provide essential services would likely result in a barrage of creditor lawsuits, which could threaten the ability of those public corporations to operate. Indeed, creditors have already begun bringing such lawsuits following the recent defaults. Aaron Kuriloff, *Insurers Sue Puerto Rico*, Wall St. J., Jan. 9, 2016, at B2. It was thus no exaggeration when a dozen United States Senators recently called Puerto Rico's situation a potential "humanitarian crisis." Letter from Richard Blumenthal et al., U.S. Senators, to Charles Grassley, Chair, Senate Judiciary Comm. (Sept. 30, 2015).[6]

3. In any of the fifty states, an eligible municipality — *i.e.*, a "political subdivision or public agency or instrumentality of a State," 11 U.S.C. § 101(40) — can reorganize its debts under chapter 9 of the federal Bankruptcy Code. To be eligible for chapter 9, the municipality must be insolvent; must have attempted to negotiate with its creditors or show that such negotiation is impractical; and must be authorized by "State law" to

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5. *Id.*

6. *Available at* http://www.puertoricoreport.com/wp-content/uploads/2015/10/Letter-to-Grassley-re-Puerto-Rico-9-30-15.pdf; *see also* White House Report, Addressing Puerto Rico's Economic and Fiscal Crisis and Creating a Path to Recovery: Roadmap for Congressional Action (Oct. 26, 2015), *available at* https://www.whitehouse.gov/sites/default/files/roadmap_for_congressional_action___puerto_rico_final.pdf.

file for bankruptcy. *See* 11 U.S.C. § 109(c) (listing eligibility requirements for chapter 9). Once a municipality files a chapter 9 case, enforcement of all creditor claims against the municipality is stayed. *Id.* § 922. During the chapter 9 case, the municipality proposes a plan to satisfy certain debts and discharge others. *See id.* §§ 941-46. That plan becomes effective only if it meets certain statutory requirements and is confirmed by the bankruptcy court after creditors have the opportunity to be heard. *Id.*

The original version of chapter 9 was enacted during the Great Depression. *See* Act of May 24, 1934, ch. 345, Pub. L. No. 73-251, 48 Stat. 798.[7] At that time, hundreds of municipalities had defaulted on their bond obligations when real estate values collapsed and many taxpayers were unable to pay their taxes. *See* S. Rep. No 73-407, at 2 (1934), J.A. 326. Congress designed chapter 9 to provide those municipalities with a "fresh start." *See* Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425, 470 (1993). In recent years, insolvent municipalities throughout the United States have invoked chapter 9 to restructure their debts, including Detroit, Michigan; Orange County, California; and Jefferson County, Alabama. *See* Michelle Wilde Anderson, *The New Minimal Cities*, 123 Yale L.J. 1118, 1120 n.1 (2014).

4. Puerto Rico's municipalities, however, are unable to file for bankruptcy under chapter 9. In 1984, Congress

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7. At various times since 1934, the federal municipal bankruptcy laws have been codified as chapters IX, X, and 9 of title 11 of the United States Code. For ease of exposition, the brief refers to the federal municipal bankruptcy laws as "chapter 9" regardless of the timeframe.

defined "State" within the Bankruptcy Code to include Puerto Rico "except for the purpose of defining who may be a debtor under chapter 9 of this title." Bankruptcy Amendments and Federal Judgeship Act of 1984, 98 Stat. 333, 369 (1984) (codified at 11 U.S.C. § 101(52)), J.A. 604. As a result, Puerto Rico can no longer provide "State law" authorization for its municipalities to file under chapter 9; and without "State law" authorization, the Commonwealth's municipalities can never meet the eligibility requirements for chapter 9. *See* 11 U.S.C. § 109(c).

Since Puerto Rico's municipalities are not permitted to reorganize their debts under federal law, when the recent state of emergency developed, the Commonwealth enacted its own municipal restructuring statute, the Puerto Rico Public Corporation Debt Enforcement and Recovery Act. Pet. App. 152a-297a. Puerto Rico's Legislative Assembly concluded that the Recovery Act was necessary "to ensure that the public corporations of the Commonwealth satisfy their debts in an orderly fashion so that indispensable services to the people of Puerto Rico may continue uninterrupted." Recovery Act, Statement of Motives § G, Pet. App. 182a.[8] Approximately $26 billion of Puerto Rico's municipal debt could be eligible to be restructured under the Recovery Act.

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8. The Recovery Act was passed pursuant to the police powers enshrined in Article II of the Commonwealth's Constitution. *See* P.R. Const. Art. II, §§ 18-19; *see also* Recovery Act, Statement of Motives § C, Pet. App. 166a-169a. In 1950, the United States Congress authorized the Commonwealth's legislature to convene a convention to draft the Commonwealth's Constitution, 48 U.S.C. § 731c, which could only become effective when approved by Congress. *Id.* § 731d. Congress did so in 1952. *See* Pub. Law No. 82-447, 66 Stat. 327 (1952).

The Recovery Act has many components. Some provide an orderly debt-enforcement mechanism; others provide a framework for negotiation with creditors; and still others provide a bankruptcy mechanism to discharge debt not paid in full after ten years. Some of the more important provisions include:

Stay to Prevent Race to Court House. The $26 billion of debt issued by those public corporations within the Recovery Act's purview, together with their pension obligations to thousands of retirees, will undoubtedly result in multiple lawsuits against any instrumentality in default. The Recovery Act addresses this problem by automatically staying enforcement of creditor claims pending the development of a restructuring plan that treats all similar claims equally. Recovery Act §§ 205, 304, Pet. App. 237a-240a, 247a-250a. This solution is modeled on historical state-court deployment of equitable mechanisms like assignments for the benefit of creditors, and bills of peace to protect against (i) the early plaintiffs enforcing their judgments and collecting to the detriment of the later plaintiffs, (ii) inconsistent judgments, and (iii) multiplication of costs and delay by repetitive litigation of the same matters.

Chapters 2 and 3. The Recovery Act provides the Commonwealth's municipal corporations with two pathways for adjusting their debt: chapter 2 and chapter 3. In a case under chapter 2, a municipal corporation negotiates with its creditors to alter the terms of its debt instruments. *Id.* § 202(a), Pet. App. 232a. Any debt adjustments negotiated in a chapter 2 case must be approved by a supermajority of creditors comprising 75% of the debt voted, and at least half the debt must vote. *Id.*

§ 202(d), Pet. App. 234a. That supermajority requirement is designed to ensure that the proposed relief is in the best interest of all creditors while preventing a few "holdouts" from scuttling the deal. In chapter 2 cases, an oversight commission is established to monitor compliance with the instrumentality's recovery program. *Id.* § 203, Pet. App. 235a-236a.

In a case under chapter 3, a municipal corporation develops a debt-enforcement plan with input from its creditors. Manifestly, none of the Commonwealth's instrumentalities can negotiate with hundreds or thousands of creditors. To facilitate that process, the court may appoint one or more committees to represent creditors. Recovery Act § 318, Pet. App. 266a-270a. The creditors' committees can retain attorneys and financial advisors at the public corporation's expense. *Id.* §§ 318(h), 319(a), Pet. App. 269a-270a. As a debt-enforcement plan is developed, the committees can be heard on various issues, including providing creditors with adequate protection for the use of collateral, any proposed foreclosure transactions, and an investigation into the instrumentality's ability to increase distributions to creditors. *Id.* § 319, Pet. App. 270a-272a.

No chapter 3 plan will take effect until it is confirmed by a court. The court must withhold confirmation unless the plan includes a series of protections that maximize distributions to creditors. For instance, a chapter 3 plan must give each creditor at least as much as it would have received had all of them gone to court to enforce their claims, *plus* a share of the municipal corporation's free cash flow for ten years until the creditor's debt is fully

satisfied. *Id.* § 315(d), (k), Pet. App. 261a-263a.[9] Moreover, no plan can be confirmed unless the public corporation can prove that it undertook a program of cost reduction and income enhancement to maximize its debt repayment. *Id.* § 315(o), Pet. App. 264a-265a. On account of protections like these, creditors in a chapter 3 case will receive more than they would in a federal chapter 9 case. In all events, the Recovery Act was tailored so that any remedy will comply with the Contract Clause.

5. The Governor of Puerto Rico signed the Recovery Act into law on June 28, 2014. That same day, dozens of investment firms holding more than $1.7 billion in PREPA bonds (the "Franklin plaintiffs") sued to enjoin the Act's enforcement. J.A. 155-56. In their complaint, the Franklin plaintiffs argued, among other things, that the Recovery Act is preempted by the federal Bankruptcy Code.[10] Less than a month later, another PREPA creditor, BlueMountain Capital Management, LLC, brought a similar suit. J.A. 200.

The district court consolidated the two cases for briefing purposes. J.A. 184, 207. The court then granted summary judgment to the Franklin plaintiffs on their preemption claim, holding that 11 U.S.C. § 903(1) expressly preempts the Recovery Act. Pet. App. 122a. Based on that preemption holding, the district court permanently

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9. The First Circuit was therefore wrong when it described the Recovery Act as providing fewer protections to creditors than chapter 9. Pet. App. 18a-19a.

10. The Franklin plaintiffs' other arguments for striking down the Recovery Act were not finally decided by the district court and are therefore not before this Court.

enjoined the Commonwealth and its officials from enforcing the Recovery Act. *Id.* at 149a.

On appeal, the First Circuit affirmed the express preemption ruling. Pet. App. 22a-43a. The First Circuit further held that the Recovery Act is barred by principles of conflict preemption. *Id.* at 44a-45a. According to the First Circuit, Congress' "undeniable purpose" in enacting § 903(1) was to block every municipal-bankruptcy law—even laws passed by jurisdictions whose municipalities cannot seek bankruptcy protection under federal law. *Id.*

Judge Torruella concurred in the judgment. Pet. App. 49a-73a. In Judge Torruella's view, § 101(52) of the Bankruptcy Code, which excludes Puerto Rico (but not the states) from invoking the protections of chapter 9 for its municipalities, is unconstitutional because Congress may only pass bankruptcy laws that are "uniform." Pet. App. 50a-51a (Torruella, J., concurring) (quoting U.S. Const. art. I, § 8, cl. 4).

Petitioners timely filed a petition for a writ of certiorari, which this Court granted on December 4, 2015.

SUMMARY OF ARGUMENT

I. This Court has long recognized that in our federal system, the states are primarily charged with protecting the health and welfare of their residents. *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 475 (1996). Consequently, this Court presumes that Congress generally does not intend to preempt a state's exercise of its police powers. *Id.* at 485 (1996). That presumption can be overcome only where Congress makes its intent to preempt "clear and

manifest." *Gregory v. Ashcroft*, 501 U.S. 452, 461 (1991). The presumption applies equally to laws enacted by Puerto Rico pursuant to its police powers. *P.R. Dep't of Consumer Affairs v. Isla Petroleum Corp.*, 485 U.S. 495, 499 (1988).

The presumption applies even when Congress enacts a law with an express preemption clause. *Medtronic*, 518 U.S. at 485. As a result, this Court has time and again held that an express preemption clause should be read narrowly and given a construction that does not result in the preemption of a particular state statute if such a construction is plausible. *CTS Corp. v. Waldburger*, 134 S. Ct. 2175, 2188-89 (2014); *Altria Grp., Inc. v. Good*, 555 U.S. 70, 77 (2008).

The Recovery Act was enacted pursuant to Puerto Rico's police powers and is therefore presumptively valid. *See* Recovery Act, Statement of Motives, Pet. App. 166a. The First Circuit nevertheless refused to apply any presumption against preemption, reasoning that any such presumption is "weak, if present at all" because bankruptcy is not a traditional area of state concern. Pet. App. 38a-39a. That is simply false as a historical matter. The states have been regulating in the field of bankruptcy since the colonial era, and they continue to enact and enforce bankruptcy laws for entities that are not covered by federal law. *See* pages 21-24, *infra*. In fact, it was only in 1898 that Congress passed the first permanent federal bankruptcy statute. Since bankruptcy is a traditional area of state regulation, the Recovery Act was entitled to the benefit of the presumption. The First Circuit's failure to recognize the presumption and apply it was a fundamental error that infected its entire statutory analysis.

II. The First Circuit held that the Recovery Act is expressly preempted by 11 U.S.C. § 903(1). But a proper analysis of that provision shows that § 903(1) preempts only municipal-bankruptcy statutes that are enacted by the states or the Commonwealth where the federal municipal-bankruptcy regime, chapter 9, is available.

This reading is confirmed by § 903(1)'s linguistic connections to the preamble of § 903. The language of that preamble refers only to municipalities that are permitted to file under chapter 9. Section 903(1) by its terms preempts only laws that affect "such municipalities"—*i.e.*, the same municipalities referenced in the preamble to § 903. In other words, § 903(1) preempts only state laws that provide for the restructuring of municipalities where chapter 9 is available. Since chapter 9 is not available to Puerto Rico's municipalities, 11 U.S.C. § 101(52), municipal bankruptcy laws passed by the Commonwealth fall outside the preemptive sweep of § 903(1).

This conclusion is confirmed by the way that Congress structured the Bankruptcy Code. Congress made it so that chapter 9 as a whole does not apply to Puerto Rico. *See* 11 U.S.C. § 101(52). And Congress placed § 903(1) within chapter 9. As a matter of law and logic, § 903(1) cannot apply to Puerto Rico when chapter 9 as a whole does not. Indeed, by placing § 903(1) within chapter 9, Congress signaled its intent that states are only bound by § 903(1) when chapter 9 is available.

In the alternative, the Recovery Act is not preempted because § 903(1) preempts only laws that bind non-consenting "creditor[s]." A "creditor" is defined in the Bankruptcy Code to mean an entity holding a claim

against a "debtor." 11 U.S.C. § 101(10). A "debtor," in turn, is a person or municipality that has commenced a federal bankruptcy case. *Id.* § 101(13). Puerto Rico's municipalities can never be debtors, however, because chapter 9 is not available to them. *Id.* § 101(52). Consequently, the creditors of Puerto Rico's municipalities can never be statutory "creditors." The Recovery Act therefore binds no "creditors" and does not run afoul of § 903(1).

The conclusion that § 903(1) does not preempt the Recovery Act is buttressed by the history of bankruptcy law and that provision itself. For nearly two centuries, this Court has recognized a simple rule of bankruptcy preemption, which permits states to pass bankruptcy laws applicable to any entity that is not covered by a federal bankruptcy statute. For example, in the years before the first permanent federal bankruptcy law, states regularly enacted and enforced their own bankruptcy regimes while there was no temporary federal law in effect. *See, e.g.*, *Tua v. Carriere*, 117 U.S. 201, 209-10 (1886). Moreover, states have long enacted bankruptcy statutes to cover insurance companies and banks, which are not covered by the federal bankruptcy laws, without being preempted. *See, e.g.*, *Neblett v. Carpenter*, 305 U.S. 297, 305 (1938); *Doty v. Love*, 295 U.S. 64, 70-74 (1935). Section 903(1) merely codified the traditional rule of bankruptcy preemption by making it clear that a state's municipal-bankruptcy laws are preempted only if chapter 9 is available to its municipalities.

Congress was compelled to codify the traditional preemption rule for municipal bankruptcies because a decision by this Court had suggested that states could pass their own municipal bankruptcy laws even when

federal chapter 9 was available. *See Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942). The legislative history shows that Congress was troubled by the prospect of state municipal-bankruptcy laws co-existing with federal chapter 9. Consequently, Congress enacted § 903(1) to clarify that a state cannot pass a municipal bankruptcy statute while the federal municipal bankruptcy statute (chapter 9) is available. But § 903(1) does not preempt a municipal-bankruptcy statute enacted by a jurisdiction—like Puerto Rico—where chapter 9 is *not* available.

ARGUMENT

I. THE RECOVERY ACT IS PRESUMPTIVELY NOT PREEMPTED.

A state's ability to enact legislation in the face of a severe fiscal crisis is a paramount function of its police powers. *See, e.g. Veix v. Sixth Ward Bldg. & Loan Ass'n of Newark*, 310 U.S. 32, 38 (1940); *Nebbia v. New York*, 291 U.S. 502, 534 (1934). And in our federal system, there is a strong presumption that laws passed pursuant to a state's police powers are valid and not preempted by federal law. *See, e.g., Waldburger*, 134 S. Ct. at 2188; *De Buono v. NYSA-ILA Med. & Clinical Servs. Fund*, 520 U.S. 806, 814 (1997). Accordingly, as a canon of federal statutory construction, this Court has repeatedly emphasized that "[t]he historical police powers of the States were not [meant] to be superseded by [a] Federal Act unless that was the *clear and manifest purpose* of Congress." *Rush Prudential HMO Inc. v. Moran*, 536 U.S. 355, 365 (2002) (emphasis added) (quotations omitted); *Medtronic*, 518 U.S. at 485; *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

For these reasons, courts do not take lightly their duty to review whether a federal law preempts a state measure undertaken pursuant to the police powers. When undertaking such a review, courts must consider whether Congress actually "faced, and intended to bring into issue, the critical matters involved in the judicial decision." *Bond v. United States*, 134 S. Ct. 2077, 2089 (2014) (quoting *United States v. Bass*, 404 U.S. 336, 349 (1971)). Accordingly, when a preemption clause has more than one plausible reading, "courts ordinarily 'accept the reading that disfavors pre-emption.'" *Altria*, 555 U.S. at 77 (quoting *Bates v. Dow Agrosciences LLC*, 544 U. S. 431, 449 (2005)).

Laws enacted by the Commonwealth of Puerto Rico pursuant to its police powers are entitled to the same presumption that they are not preempted by federal law. *See Isla Petroleum*, 485 U.S. at 499. There is no question that Puerto Rico was relying on its police powers when it passed legislation in response to the "most critical" fiscal situation in the history of the Commonwealth. Recovery Act, Statement of Motives § A, Pet. App. 153a. As the Act itself recited, without legislative action, the Commonwealth faced the prospect of "an unprecedented failure in the ability of some public corporations to safeguard the public and promote the general welfare of the people by continuing to provide essential government services." *Id.* at 162a. Indeed, Puerto Rico explicitly invoked its "police power to enact orderly debt enforcement . . . when facing an economic emergency" as the authority underlying the Recovery Act. *Id.* at 166a. It would be difficult to imagine a more legitimate exercise of the police powers than one undertaken in the face of this severe economic and fiscal crisis, with no federal restructuring option available.

Indeed, this Court has long recognized that the police powers can be invoked to address urgent public needs produced by economic causes. *See, e.g., Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 437, 440 (1934).

The First Circuit, nevertheless, concluded that any presumption that the Recovery Act is not preempted is "weak, if present at all." Pet. App. 38a-39a. It reasoned that bankruptcy is not a traditional area of state regulation, *id.* (citing *United States v. Locke*, 529 U.S. 89, 108 (2000)), and therefore that there was no basis to assume that Congress aimed to avoid displacing state law.

But that factual premise is simply incorrect. States have been enacting and enforcing bankruptcy statutes for over two hundred years. *See, e.g.*, Laws of the State of New York 1788, ch. 92; Laws of Maryland 1805, ch. 110; Acts of the General Assembly of Pennsylvania 1814, ch. 3926; Laws of the State of Alabama 1821 tit. 24, ch. 19; Revised Statutes of the State of Indiana 1831 ch. 27; *see also Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 365 (2006) (noting that "the American Colonies, and later the several States, had wildly divergent schemes for discharging debtors and their debts"). Even today, the states (and Puerto Rico) provide bankruptcy protection to entities such as banks and insurance companies that are ineligible to file for federal relief. *See, e.g.*, Cal. Fin. Code § 648 (banks); N.Y. Banking Law § 610 (banks); Ky. Rev. Stat. Ann. §§ 304.33-010 to 304.33-600 (insurance companies); Wis. Stat. Ann. §§ 645.01 – 645.90 (insurance companies).[11] This Court

11. *See also, e.g.*, Ariz. Rev. Stat. Ann. §§ 6-489 to 6-494 (banks); Cal. Fin. Code § 648 (banks); Haw. Rev. Stat. §§ 412:2-400 to 412.2-421 (banks); Ind. Code Ann. §§ 28-1-20-8 (banks);

has consistently recognized that these state bankruptcy laws are valid exercises of the states' police powers and are not preempted by federal law. *See, e.g., Neblett*, 305 U.S. at 305; *Doty*, 295 U.S. at 70-74.

In fact, until 1898, enacting insolvency legislation was *mostly* the prerogative of the states. Prior to the twentieth century, Congress did not pass a single permanent bankruptcy statute. Rather, it passed a series of temporary bankruptcy measures with short sunset periods during times of economic crisis, which were in effect for only sixteen years during the entire nineteenth century. *See Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 184 (1902); Todd J. Zywicki, *The Past, Present, and Future of Bankruptcy Law in America*, 101 Mich. L. Rev. 2016, 2018 (2003); *see also* pages 35-39, *infra*.

Nor is it any response to say that *municipal* bankruptcy is not a traditional area of state regulation. First, this Court has never parsed the relevant field of regulation so narrowly when determining whether the presumption

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Md. Code Ann., Fin. Inst. §§ 5-611 to 5-615 (banks); Mich. Comp. Laws Ann. §§ 487.3601 – 487.3608 (banks); N.Y. Banking Law § 610 (banks); Okla. Stat. tit. 6 §§ 1201 – 1207 (banks); P.R. Laws Ann. tit. 7 §§ 201 – 215 (banks); S.C. Code Ann. §§ 34-5-110 to 34-5-150 (banks); Conn. Gen. Stat. §§ 38a-903 to 38a-965 (insurance companies); Fla. Stat. §§ 631.001 – 631.401 (insurance companies); Ky. Rev. Stat. Ann. §§ 304.33-010 to 304.33-600 (insurance companies); La. Rev. Stat. Ann. §§ 22:2001 – 22:2050 (insurance companies); Mass. Gen. Laws Ann. ch. 175, § 180 (insurance companies); Neb. Rev. Stat. §§ 44-4801 to 44-4862 (insurance companies); Or. Rev. Stat. Ann. §§ 734.014 – 734.440 (insurance companies); P.R. Laws Ann. tit. 26, §§ 4001–4013 (insurance companies); Tex. Ins. Code Ann. §§ 443.001 – 443.402 (insurance companies).

against preemption applies. In *Hillman v. Maretta*, for example, the Court afforded such a presumption to a Virginia law governing life-insurance beneficiaries. 133 S. Ct. 1943, 1950 (2013). The presumption arose not because Virginia had extensively legislated in the narrow field of life-insurance beneficiaries, but rather because the statute fell under the broader umbrella of domestic relations, which is "traditionally the domain of state law." *Id.*[12]

Similarly, in *California v. ARC America Corp.*, the Court applied the presumption against preemption to a California antitrust statute that—unlike the federal antitrust laws—explicitly permitted recovery by indirect purchasers. 490 U.S. 93, 99-101 (1989). In concluding that the presumption applies, the Court did not consider whether states have traditionally regulated the narrow issue of antitrust standing. Rather, the Court cited the "long history of state common law and statutory remedies against monopolies and unfair business practices." *Id.* at 101. In other words, the Court determined that the presumption applied because the state statutes at issue fell within a broader field—monopolies and unfair business practice—that was traditionally regulated by the states. *Id.* By the same logic, the Recovery Act is entitled to a presumption against preemption because it falls comfortably within the ambit of bankruptcy law in general, which has been an area of state concern since the colonial era.

Second, the states have a long history of implementing remedial measures for distressed municipalities. Historically, states undertook a variety of remedial

12. The Court ultimately held that the state statute in *Hillman* was preempted for reasons that have no bearing here.

actions to assist municipalities in default. *See* A.M. Hillhouse, Municipal Bonds: A Century of Experience 321 (1936) (explaining that "refunding legislation, statutes controlling compromises, voluntary and involuntary court receiverships and state administrative receiverships—all have their roots in history"). The very provision at the center of this case—§ 903(1)—was passed in response to a decision by this Court upholding a New Jersey municipal-bankruptcy law. *See Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942). State municipal-bankruptcy statutes are not the norm today only because beleaguered municipalities usually have access to federal bankruptcy relief under chapter 9. *See* 6 Collier on Bankruptcy ¶ 903.03(2) (16th ed. 2015).

The more significant point is that the states and Puerto Rico have a vital interest in promoting and safeguarding the financial health of their municipalities by using their police powers. *See, e.g., Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 506-07 (1986) (holding that a bankruptcy provision which authorizes a bankruptcy trustee to abandon property does not preempt state health and safety laws, and finding no congressional intent for the Bankruptcy Code to interfere with a state's ability to protect its citizens). Section 903 itself recognizes the interest the states have in "control[ling], by legislation or otherwise" their municipalities, including the "expenditures" needed so those municipalities can continue to function. 11 U.S.C. § 903. That is the backdrop against which Congress enacted § 903(1). And it is precisely the reason to presume that Congress did not intend to prevent Puerto Rico from devising its own methods of debt restructuring for its imperiled utilities and other public corporations, since federal relief is unavailable.

This is particularly the case when the federal statute provides no regulatory framework in place of the supposedly preempted law. Here, the First Circuit stripped Puerto Rico of its police powers and left the Commonwealth in a "no man's land" with no statutory mechanism to deal with its crippling debt. The First Circuit disputed that a "no-man's land" was created, stating instead that all Congress did here was "retain its own authority by denying to Puerto Rico both the power to choose Chapter 9 relief and to enact its own version thereof." Pet. App. 30a-32a n.24. But that is precisely the definition of a no-man's land. Congress can always legislate. At any time, it can permit Puerto Rico to utilize chapter 9; it does not need to retain authority to do so. And there is no question here that Puerto Rico is left by the First Circuit's decision with its hands tied behind its back. Indeed, Puerto Rico is left with no orderly restructuring process, an inevitable race to the courthouse by its creditors, and the possibility that Puerto Rico's public utilities will be unable to continue providing certain vital services to its citizens, among other things. The presumption should apply with full force here.

For all of these reasons, the Recovery Act is a presumably valid exercise of Puerto Rico's police power. Accordingly, if there is a plausible construction of 11 U.S.C. § 903(1) that does not result in the Recovery Act being preempted, this Court must adopt that construction. *Altria*, 555 U.S. at 77; *Bates*, 544 U.S. at 449.

II. THE RECOVERY ACT IS NOT PREEMPTED BY THE FEDERAL BANKRUPTCY CODE.

Whether a federal statute preempts a state law is a question of congressional intent. *Altria*, 555 U.S. at 76. Where, as here, Congress has enacted an express preemption provision, the inquiry becomes whether the state law at issue falls within the preemptive sweep of that federal provision. *See, e.g., Sprietsma v. Mercury Marine*, 537 U.S. 51, 62-64 (2002). The intended scope of an express preemption provision can be discerned by examining its plain language, as well as the "structure and purpose of the statute as a whole." *Medtronic*, 518 U.S. at 486; *see also Dan's City Used Cars, Inc. v. Pelkey*, 133 S. Ct. 1769, 1778-80 (2013). Here, the text, structure, purpose, and history of § 903(1) all show that the provision does not preempt the Recovery Act.

In construing 11 U.S.C. § 903(1) to expressly preempt the Recovery Act, the First Circuit improperly read § 903(1) in isolation without considering how it interacts with the rest of the Bankruptcy Code. The First Circuit thereby ignored the "fundamental canon of statutory construction" that "the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (quoting *Davis v. Mich. Dep't of Treasury*, 489 U.S. 803, 809 (1989)); *see also United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988).

A. Section 903(1) By Its Terms Does Not Preempt the Recovery Act.

1. As expressed in its title—"Reservation of State power to control municipalities"—the purpose of § 903 is to preserve a state's powers over its municipalities in the face of a chapter 9 proceeding. This purpose is embodied in the opening words of § 903's preamble, which provides that "[t]his chapter does not limit or impair the power of a State to control . . . a municipality of or in such State in the exercise of the political or governmental powers of such municipality," meaning a municipality in a state whose powers might otherwise be limited or impaired by chapter 9. 11 U.S.C. § 903. This reading also accords with common sense: It would be pointless for Congress to decree that chapter 9 does not impede a state's control over a municipality to which chapter 9 does not apply in the first place. *See Sprietsma*, 537 U.S. at 63-64 (emphasizing that Court's interpretation of preemption clause should avoid anomalous results).

Section 903(1) is inextricably linked to the preamble of § 903. The preamble ends with the word "but," indicating that what follows serves as an exception to the rule that nothing in the chapter itself limits the power of a state to control a municipality *to which chapter 9 applies*. In other words, § 903(1) applies to the subset of municipalities of states that can become chapter 9 debtors. The text of § 903(1) works the same way, as it prohibits a state law that "prescrib[es] a method of composition of indebtedness of *such municipality*" from binding a non-consenting creditor. 11 U.S.C. § 903(1) (emphasis added). The italicized words necessarily refer back to the municipalities described in § 903's preamble—*i.e.*,

those municipalities covered by chapter 9. *See, e.g.*, *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015) (explaining that "such" means "[t]hat or those; having just been mentioned"); *Pennsylvania v. Coxe*, 4 U.S. (4 Dall.) 170, 202 (Pa. 1800) (Yeates, J., concurring) ("[T]he terms 'such actual settlement' . . . refer to the settlement described in the foregoing part . . . ."). Accordingly, § 903(1) bars only certain types of municipalities from binding dissenting creditors under state law: those municipalities for which chapter 9 is available.

Chapter 9 is not available to Puerto Rico's municipalities, however. That is because § 109(c)—which falls within the section titled "Who may be a debtor" and spells out the eligibility criteria for chapter 9—provides that only insolvent municipalities authorized by "State law" to seek bankruptcy protection may file for chapter 9 relief. 11 U.S.C. § 109(c). The term "State" is elsewhere defined to include Puerto Rico, "except for the purpose of defining *who may be a debtor* under chapter 9." *Id.* § 101(52) (emphasis added). The italicized language is a cross-reference to § 109. The combined effect of these provisions is that Puerto Rico municipalities cannot avail themselves of chapter 9. As a result, Puerto Rico's municipalities are not among "such municipalit[ies]" encompassed by § 903(1); and since the Recovery Act cannot bind any creditors of "such municipalities" within the meaning of § 903(1), it is not preempted.

2. An examination of the Bankruptcy Code's architecture—specifically, where § 903(1) is located—further demonstrates why the Recovery Act is not preempted. *See Univ. of Tex. Sw. Med. Ctr. v. Nassar*, 133 S. Ct. 2517, 2529 (2013) ("Just as Congress' choice

of words is presumed to be deliberate, so too are its structural choices."); *Nken v. Holder*, 556 U.S. 418, 430 (2009) (explaining that location of statutory provision is probative of the meaning of its words). The Code is divided into a series of chapters. Chapters 1, 3, and 5 contain provisions generally applicable to all bankruptcy cases. *See* 11 U.S.C. § 103(a). By contrast, chapters 7, 9, 11, 12, 13, and 15 contain rules that govern only in specific types of bankruptcy cases. "[A]s a general rule, the provisions of [chapters 7, 9, 11, 12, and 13] apply only in that chapter." 1 *Collier Pamphlet Edition, Bankruptcy Code 2015* at 59 (Alan N. Resnick & Henry J. Sommer eds., 2015).

As the section which determines who may be a debtor under the Bankruptcy Code, § 109 functions as the "gateway" to chapters 7, 9, 11, 12, 13, and 15, defining the eligibility requirements for each individual or entity seeking to file for relief under one of those chapters. For example, subsection 109(f) provides that only family farmers and fishermen are eligible to file for chapter 12 relief, while subsection 109(e) provides that only individuals with certain types of debts can file for chapter 13 relief. As noted, Puerto Rico's municipalities are barred from filing for chapter 9 because they cannot pass through the gateway of § 109(c). And if chapter 9 does not apply to Puerto Rico, then neither can § 903(1), because it is contained *within* chapter 9.

If Congress had intended for § 903(1) to apply to entities excluded from chapter 9, it knew how to do so by explicitly stating that § 903(1) applies outside chapter 9. *See, e.g.*, 11 U.S.C. § 103(k)(2) (decreeing that certain provisions of chapter 15 apply outside chapter 15 and outside any case under the Bankruptcy Code). Instead,

Congress placed § 903(1) within a chapter that is entirely inapplicable to Puerto Rico's municipalities. In so doing, Congress evidenced its intent not to preempt municipal bankruptcy laws enacted by the Commonwealth.

Moreover, when Congress wants to expressly preempt, it knows precisely how to do so, using unequivocal language. *See, e.g., Aetna Health, Inc. v. Davila,* 542 U.S. 200, 204 (2004) (state law preempted by ERISA, which provides that it "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan"); *Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist.*, 541 U.S. 246, 252-55 (2004) (state law preempted by Clean Air Act, which provides: "No State or any political subdivision thereof shall adopt or attempt to enforce any standard relating to the control of emissions from new motor vehicles or new motor vehicle engines"); *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 867-68 (2000) (state law preempted by National Traffic and Motor Vehicle Safety Act, which provides: "Whenever a Federal motor vehicle safety standard established under this subchapter is in effect, no State or political subdivision of a State shall have any authority either to establish, or to continue in effect . . . any safety standard applicable to the same aspect of performance"). With its mix of terms like "such State" and "such municipality," in concert with the exclusion of Puerto Rico from chapter 9 altogether, no such unequivocal language exists here.

Indeed, it would be highly ironic if a provision within § 903, which was enacted to allay concerns that chapter 9 might wrest too much control from the states, would leave Puerto Rico in a "no-man's land," unable to invoke bankruptcy options under either Commonwealth

or federal law. Section 903 was enacted following this Court's decision in *Ashton v. Cameron County Water Improvement District No. 1*, 298 U.S. 513, 529-31 (1936), which held that the original version of chapter 9 violated the Tenth Amendment because it gave federal courts too much control over a state's municipalities. Following *Ashton*, Congress included the predecessor to § 903 (which, at the time, included only language similar to that in the preamble) in a new municipal-bankruptcy regime to clarify that federal bankruptcy proceedings would not affect a state's control over its municipalities. This Court upheld that new municipal-bankruptcy scheme against a Tenth Amendment challenge in part because of § 903. *See United States v. Bekins*, 304 U.S. 27, 49-51 (1938) (noting that the new municipal bankruptcy law was "carefully drawn so as not to impinge upon the sovereignty of the State"). The First Circuit's decision turns the federalism principle underlying § 903 on its head by holding that the provision renders Puerto Rico helpless to address the crisis plaguing its municipalities.

B. Section 903(1) Additionally Does Not Preempt the Recovery Act Because Puerto Rico's Municipalities Have No "Creditors" As Defined by the Code

An alternate argument that the Recovery Act must be valid is based on the definitions of the key terms "creditor" and "debtor." Section 903(1) does not preempt the Recovery Act because Puerto Rico has no "creditors" within the plain meaning of the Bankruptcy Code.

By its terms, § 903(1) renders state-law compositions unenforceable only against non-consenting "creditors."

"Creditor" is defined in the Code to mean "an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. § 101(10)(A).[13] "Debtor" is defined as a person or municipality concerning which a bankruptcy case has been commenced. *Id.* § 101(13). Puerto Rico's municipalities can never commence a bankruptcy case because they are barred from chapter 9. *Id.* § 101(52). Consequently, Puerto Rico's municipalities can never be "debtors" and cannot have any "creditors" within the meaning of § 903(1). Since the Recovery Act binds no "creditors," it falls outside § 903(1)'s preemptive sweep.

Amendments to the definition of "creditor" show that Congress intended to tie it closely to the existence of an actual bankruptcy case. In 1946, chapter 9 defined "creditor" simply as a holder of "bonds, notes, judgments," and other kinds of indebtedness. Act of July 1, 1946, Pub. L. No. 79-481, 60 Stat. 409, § 82, J.A. 558. In 1976, that definition was changed to provide that "creditor" meant the holder of a claim "*against the petitioner.*" Act of April 8, 1976, Pub. L. No. 94-260, 90 Stat. 315, § 81(3), J.A. 579 (emphasis added). In 1978, the chapter 9-specific definition was folded into the general definitions. But it, too, stated that "creditor" meant the creditor of a "debtor," which in turn meant a party that had commenced a bankruptcy case. An Act to Establish a Uniform Law on the Subject of Bankruptcies (the Bankruptcy Code), Pub. L. No. 95-598, 92 Stat. 2549, § 101 (1978), J.A. 588.

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13. "Creditor" has two additional statutory definitions that plainly cannot apply in chapter 9 because there is no "estate" and because only individuals can have a "community claim." 11 U.S.C. § 101(10)(B)-(C).

Although the First Circuit conceded that § 903(1) would not preempt the Recovery Act if the statutory definitions applied, Pet. App. 34a-35a, it nevertheless believed that "construing 'creditor' in § 903(1) so narrowly" would allow each state to evade § 903(1) by simply withholding municipal authorization to file under chapter 9. *Id.* The court failed to appreciate, however, that the municipalities in all fifty states are covered by chapter 9—unlike the municipalities in Puerto Rico. Under the traditional rules of bankruptcy preemption, *see* pages 35-41, *infra*, states that are able to invoke federal bankruptcy protection for their municipalities are not permitted to pass their own statutes—notwithstanding the scope of § 903(1). Accordingly, applying the statutory definition of "creditor" does not undermine any intent embodied in § 903(1).[14]

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14. The First Circuit claimed that the Bankruptcy Code "is replete with use of the term 'creditor' in ways not limited by the statutory definition." Pet. App. 36a n.28. For example, the First Circuit trumpeted Bankruptcy Code § 502(a), which refers to a "creditor of a general partner in a partnership that is a debtor." *Id.* (citing 11 U.S.C. § 502(a)). According to the lower court, the "creditor" referenced there does not have a claim against a debtor satisfying the statutory definition (*i.e.*, a debtor subject to a Title 11 case), but rather a claim against a partner in the debtor partnership. *Id.* But 11 U.S.C. § 723(c) makes it clear that a creditor of the general partner is indeed a statutory "creditor." That provision states that "[t]he trustee has a claim against the estate of each general partner in such partnership that is a debtor." *Id.* The reference to the general partner's *estate* reveals that the general partner is a Title 11 debtor itself because an estate is only created when a bankruptcy case is commenced. 11 U.S.C. § 541(a). The legislative history corroborates this conclusion. *See* H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6447-48 ("Section 502(a) has been modified to make clear that a party in interest includes a creditor of a partner in a partnership that is

C. The Statutory History Reinforces The Textual Reading.

This Court historically has taken a consistent approach to preemption in the context of bankruptcy practice. Since the earliest days of the Republic, state bankruptcy laws have been held preempted if they cover entities that can seek relief under federal law. Conversely, the states are free to enact their own bankruptcy laws for the benefit of entities that are ineligible for federal relief.

Section 903(1) did nothing more than codify this traditional rule with respect to municipalities. As § 903(1)'s own history shows, Congress has consistently intended that municipalities should be able to avail themselves of *some* form of relief. If Congress provides a mechanism for restructuring debt, then the states are foreclosed from offering their own. But if federal relief is not available, then the states are free to innovate on their own. Accordingly, since Puerto Rico's municipalities are excluded from chapter 9, they should be free to avail themselves of the Recovery Act.

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a debtor under chapter 7. Since the trustee of the partnership is given an absolute claim against the estate of each general partner under section 723(c), creditors of the partner must have standing to object to claims against the partnership at the partnership level because no opportunity will be afforded at the partner's level for such objection"). The "creditors" mentioned in § 502 therefore do have claims against a debtor in a case under Title 11. The other examples cited by the First Circuit can similarly be dismissed.

1. The Traditional Rule of Bankruptcy Preemption Allows States to Pass Bankruptcy Statutes When Federal Law Is Unavailable.

For nearly two centuries, this Court has recognized a simple rule that governs preemption in bankruptcy. States are permitted to enact bankruptcy regimes that apply to entities excluded from federal bankruptcy law. *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819). For example, states may pass bankruptcy statutes that cover banks and insurance companies, *see, e.g.*, *Neblett*, 305 U.S. at 305 (insurance companies); *Doty*, 295 U.S. at 70-74 (banks), because those entities are barred from federal bankruptcy protection by the Code's gateway provision, 11 U.S.C. § 109(b)(2); *see also Gibbes v. Zimmerman*, 290 U.S. 326, 332 (1933) (upholding South Carolina laws governing insolvent banks); *Noble State Bank v. Haskell*, 219 U.S. 104, 109 (1911) (upholding Oklahoma measures as authorized use of police power to ensure full payment of depositor claims in case of bank insolvency). On the other hand, a state is unable to pass its own bankruptcy laws for the benefit of entities that are covered by federal law. As Justice Story explained, to the extent that state insolvency laws "apply *at the same time to the same persons*" as a federal bankruptcy statute, the state laws are suspended. *Ex Parte Eames*, 8 F. Cas. 236, 237 (C.C.D. Mass. 1842) (Story, J.) (emphasis added). "This, as far as I know," he wrote, "has been the uniform doctrine, maintained in all the courts of the United States." *Id.*

This traditional rule of bankruptcy preemption often came into play during the nineteenth century, when Congress enacted temporary bankruptcy statutes that

would sunset after a few years. During that era, once a federal bankruptcy statute took effect, state insolvency laws were "suspended" to the extent that they applied to the same entities; but as soon as the federal statute expired or was repealed, the state insolvency laws were "vivified" and automatically took effect again. *Tua*, 117 U.S. at 209-10; *see also Stellwagen v. Clum*, 245 U.S. 605, 613 (1917) (holding that state insolvency laws are suspended "only to the extent of actual conflict" with federal bankruptcy statute); Stephen J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 Am. Bankr. L.J. 553, 566 (2014) (explaining that "in the absence of Congressional action . . . the States retain the residual power to address insolvency").

2. Section 903(1) Codified the Traditional Rule of Bankruptcy Preemption for Municipalities.

The traditional rule remained unquestioned until 1942, when this Court held that states could enforce their own municipal-bankruptcy statutes even if their municipalities could seek relief under chapter 9 of the Bankruptcy Code. *See Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942). The *Faitoute* decision marked the first time that a state insolvency statute was permitted to co-exist with a federal bankruptcy law that covered the same entities.

In *Faitoute*, the debts of Asbury Park, New Jersey, were reorganized under state law in July 1937, at a time when federal law offered no remedy. *Id.* at 507-08. Although 85% of the creditors accepted delayed payment at lower interest rates, others objected, arguing that the

subsequent enactment of a federal municipal-bankruptcy statute preempted the state-law restructuring that was already underway. *Id.* This Court invoked the traditional preemption rule to hold that New Jersey had the power to enforce its own municipal-bankruptcy statute while there was no federal municipal statute in effect (and to enforce a composition previously approved by a New Jersey court). *Id.* But the Court also announced a "broader" holding that states can enact their own municipal-bankruptcy laws even if Congress has provided its own mechanism. *Id.* at 508-09. *Faitoute* thus rejected the traditional rule of bankruptcy preemption for insolvent municipalities.

Congress responded to *Faitoute* by enacting § 903(1), which overturned the case's broader holding and clarified that states cannot enforce their own municipal-bankruptcy statutes while chapter 9 is available.[15] *See Ropico, Inc. v. City of N.Y.*, 425 F. Supp. 970, 979-81 (S.D.N.Y. 1976) (explaining that § 903(1) was enacted in response to holding in *Faitoute*); *Amending Municipal Bankruptcy Act: Hearings on H.R. 4307 Before Special Subcomm. on Bankr. & Reorg. of the H. Comm. of the Judiciary*, 79th Cong. 16 (1946) (statement of attorney Millard Parkhurst) (expressing concern that under the holding in *Faitoute*, "the 48 States can have their bankruptcy laws running right along at the same time as" chapter 9), J.A. 445. In subsequent amendments to § 903(1), Congress has adhered to this position. *See* S. Rep. No. 95-989, at 110 (emphasizing

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15. The current § 903(1) was originally codified at § 83(i) of the federal municipal-bankruptcy statute. Congress re-codified the provision at § 903(1) in 1978 without making substantive changes. *See* S. Rep. No. 95-989, at 110. For ease of exposition, this brief will refer to the provision as "§ 903(1)" regardless of the timeframe.

purpose of preventing states from "'enact[ing] their own versions of Chapter IX'"), J.A. 509.

Section 903(1)'s own history indicates that Congress's intent was to codify the traditional preemption rule. As originally drafted, the proposed text of § 903(1) began by stating that the provision would be operative only "while this chapter [chapter 9] is in effect."[16] That language made sense because chapter 9 was scheduled to sunset after several years, and Congress evidently wanted to make clear that the state-law limitation contained in § 903(1) would dissipate once the federal option was no longer available.[17] In 1946, Congress decided for the first time to make chapter 9 permanent. As a result, it dropped § 903(1)'s introductory phrase ("while this chapter is in effect") since it was no longer necessary. Act of July 1,

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16. H. R. 4307, 79th Cong. § 83(i) (1945) ("*Provided, however, That while this chapter is in effect*, no State law prescribing a method of composition of indebtedness of such agencies shall be binding upon any creditor who does not consent to such composition, and no judgment shall be entered under such State law which would bind a creditor to such composition without his consent." (emphasis added)), J.A. 402.

17. The original chapter 9 was scheduled to sunset in two years. Act of May 24, 1934, Pub. L. No. 73-251, § 79, 48 Stat. 798, 798. That sunset period was extended by a series of subsequent enactments before chapter 9 was finally made permanent in 1946. *See* Act of Apr. 10, 1936, Pub. L. No. 74-507, § 79, 49 Stat. 1198, 1998 (extending sunset by four years); Act of Aug. 16, 1937, Pub. L. No. 75-302, § 84, 51 Stat. 653, 659 (further three-year extension); Act of June 28, 1940, Pub. L. No. 76-669, § 84, 54 Stat. 667, 670 (further two-year extension); Act of June 22, 1942, Pub. L. No. 77-622, § 84, 56 Stat. 377, 377 (further four-year extension). When the original draft of what became § 903(1) was written in 1945, chapter 9 was scheduled to sunset on June 30, 1946.

1946, Pub. L. No. 79-481, § 83(i), 60 Stat. 409, 415-16, J.A. 402; H.R. Rep. No. 79-2246, at 4 (1946), J.A. 431. But there is no indication that Congress changed its mind about the overarching rule—that if federal municipal relief ever again became unavailable, state-law remedies would not be foreclosed.

This view is reinforced by a presumption on which the First Circuit relied heavily, albeit for the wrong result. It is a time-honored principle that this Court "'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998) (quoting *Pa. Dep't of Pub. Works v. Davenport*, 495 U.S. 552, 563 (1990)); *see also Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) ("When Congress amends the bankruptcy laws, it does not write 'on a clean slate.'"). There is no evidence—let alone a "clear indication"—that Congress abandoned the traditional preemption rule in 1946. Congress may have disagreed with *Faitoute*'s ruling that chapter 9 allowed both state law and federal law to coexist, but nothing in that decision put at issue the long-standing practice of allowing states to pass bankruptcy laws when federal remedies for an entity did not exist. Accordingly, one must assume that no change in that practice was contemplated.

The First Circuit reached a different conclusion about § 903(1) because it misapprehended the historical record. The court was correct that § 903(1)'s predecessor was passed to restore the "pre-*Faitoute* status quo." Pet. App. 25a. But it misconstrued that status quo, supposing that states could never provide any form of municipal-bankruptcy relief without offending the Contract Clause.

See id. As the historical survey above shows, that supposition is simply not correct. Indeed, *Faitoute* itself emphatically rejected it. According to *Faitoute*, states had long been recognized to retain the power to provide bankruptcy relief for building-and-loan associations and banks, entities not covered by federal law. 316 U.S. at 513-14 (citing *Veix v. Sixth Ward Building & Loan Ass'n*, 310 U.S. 32, 38 (1940), and *Doty v. Love*, 295 U.S. 64 (1935)). "If a state retains police power with respect to" those entities, the Court reasoned, it "should certainly not be denied a like power for the maintenance of its political subdivisions." *Id.* There was no indication that *Faitoute* was breaking new ground on this point.[18]

Because the First Circuit began at the wrong starting point, its entire historical analysis foundered. Section 903(1) did not "restore" a status quo whereby states were powerless to aid their insolvent municipalities. *See* Pet. App. 25a. Instead, the status quo was that they could take any measure that did not "conflict with the system provided by the Bankruptcy Act of Congress," *Stellwagen*, 245 U.S. at 613, provided that measure was sufficiently protective of contractual rights and there was no federal municipal bankruptcy option available. Nothing in § 903(1) changed that. And if there was no "evidence of express modification by Congress" of that rule when

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18. *Faitoute* pointed out that this had long been the law. 316 U.S. at 514 n.2 (quoting *Chi., Burlington & Quincy R.R. v. Nebraska*, 170 U.S. 57, 72 (1898) ("Contracts [dealing with public rights] . . . are held to be within the supervising power and control of the legislature when exercised to protect the public safety, health and morals, and that clause of the Federal Constitution which protects contracts from legislative action cannot in every case be successfully invoked.")).

Congress made later amendments to § 903(1), Pet. App. 27a, that simply proves that the traditional preemption rule remained in effect.

The First Circuit's misguided view of the statutory history also led it to strike down the Recovery Act on the "alternative ground" of conflict preemption. *See* Pet. App. 43a-45a. According to the First Circuit, the Recovery Act frustrated Congress's "undeniable purpose" in passing § 903(1) of preempting all municipal-insolvency laws. *Id.* at 44a. Again, however, the court's unnuanced view of Congressional purpose must be rejected. There is no evidence that Congress intended to block municipal-bankruptcy laws enacted by jurisdictions whose municipalities had no access to federal law. *Faitoute* did not involve such a situation; indeed, at the time of § 903(1)'s passage, every municipality in the United States, including those in Puerto Rico, were covered by chapter 9. There is thus no reason to suppose that Congress enacted § 903(1) to thwart laws passed by states where chapter 9 was unavailable; that situation had not even presented itself.[19]

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19. Nor was the First Circuit correct to rely on Congress's supposedly overriding concern for uniformity in municipal-bankruptcy law. *See* Pet. App. 44a. Congress plainly spurned uniformity when it made chapter 9 unavailable to Puerto Rico and the District of Columbia alone. *See* 11 U.S.C. § 101(52); *see also* Pet. App. 51a-54a (Torruella, J., concurring).

3. There Is No Evidence That Passage of the 1984 Amendment Was Intended to Change the Traditional Rule.

The final development in the story of Puerto Rico's exclusion from chapter 9 occurred in 1984, when Congress defined "State" in the Bankruptcy Code. 11 U.S.C. § 101(52). There is no legislative record revealing the congressional purpose behind that amendment. *See* Pet. App. 28a-29a n.23. It was not debated on the floor of Congress, nor discussed in any legislative document.[20] There is no dispute that, as a result of the change, Congress withdrew chapter 9 relief from Puerto Rico's municipalities. But there is also no indication that Congress meant to change the traditional preemption rule and block both avenues for obtaining a remedy in bankruptcy. No evidence exists that Congress actually "faced and intended" to bring into issue such dire consequences for Puerto Rico. *Bond*, 134 S. Ct. at 2089.

In light of the presumption that Congress does not upend longstanding bankruptcy practice without a clear indication, *Cohen*, 523 U.S. at 221; *Dewsnup*, 502 U.S. at 419, one must assume that Congress did not intend to change that traditional rule. Rather, the 1984 amendment should be viewed as creating a situation equivalent to those that arose frequently when federal bankruptcy statutes were temporary: Federal bankruptcy relief was no longer

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20. Indeed, the only mention of this amendment came from bankruptcy expert Professor Frank Kennedy, who stated that he did not understand why Puerto Rico was being excluded from chapter 9. *Hearing on S. 333 & S. 445 before the Senate Comm. on the Judiciary*, 98th Cong., 1st Sess. (April 6, 1983) (statement of Frank Kennedy), J.A. 538.

available to Puerto Rico's municipalities, and thus Puerto Rico was permitted to fill the gap.

To make its ruling appear more plausible, the First Circuit speculated about Congress's possible reasons for cutting off both federal and local relief to Puerto Rico's municipalities. It posited that Congress might have wanted to retain for itself control over municipal bankruptcies in the Commonwealth so that it could adopt "other" and "possibly better" measures. Pet. App. 30a, 47a. As the concurrence noted, that theory of congressional purpose is "pure fiction" without a shred of support in the legislative record. *Id.* at 56a-57a (Torruella, J., concurring). Indeed, the theory does not even make sense on its own terms. Congress's ability to exercise "other options" would not be undermined if Puerto Rico could fashion its own municipal-bankruptcy relief. Congress can always intervene in innumerable ways if it chooses. Thus, Congress did not need to expressly reserve that right in 1984.

4. The Unprecedented Nature of the First Circuit's Reading of § 903(1) Undercuts Its Plausibility.

The First Circuit construed § 903(1) to effect a sea change in bankruptcy jurisprudence. In the history of the United States, there has never been an entity that was forbidden from seeking bankruptcy protection under either federal or local law. Under the First Circuit's ruling, however, municipalities in Puerto Rico are now categorically barred from seeking bankruptcy protection under any law. Moreover, the First Circuit concluded that Congress accomplished this fundamental change by amending the definition of "State" in § 101(52) of the Bankruptcy Code, and without any debate or discussion

in the legislative history. That conclusion is implausible on its face. "Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes." *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001).

D. The Court Should Accept the Textual Reading of § 903 that Disfavors Preemption.

Given the strong presumption that Congress would not have intended to interfere with Puerto Rico's exercise of its police powers, *Medtronic*, 518 U.S. at 485, or with the Commonwealth's ability to manage its municipalities, 11 U.S.C. § 903, this reading of § 903(1) should carry the day. *See Altria*, 555 U.S. at 77 (explaining that where there is more than one plausible reading of a statute, the Court should adopt the one that disfavors preemption).

Indeed, reaching the contrary conclusion—that § 903(1) preempts the Recovery Act even though chapter 9 is unavailable in Puerto Rico—requires a series of analytic gymnastics. First, the Court must conclude that § 903(1) somehow applies to the Commonwealth even though chapter 9 as a whole does not. Second, the Court must disregard the link between § 903(1) and the preamble to § 903. Third, the Court must disregard the statutory definition of "creditor." Fourth, the Court must discount two centuries of bankruptcy practice that formed the backdrop to § 903(1). And finally, the Court must assume that Congress responded to the circumscribed problem in *Faitoute*—state municipal bankruptcy law running alongside chapter 9—with a sledgehammer: a complete ban on state municipal bankruptcy laws even if chapter 9 becomes unavailable.

This Court can find preemption only if Congress has made its intent to preempt the Recovery Act "clear and manifest." *Rush Prudential*, 536 U.S. at 365. The requisite clarity is simply absent here, and thus no intent to preempt should be found.

CONCLUSION

For the foregoing reasons, the decision of the First Circuit should be reversed.

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